UNITED
NATIONS

TD

United Nations Conference
on Trade and Development

Distr.
GENERAL

TD/B/WG.1/2
26 August 1992

Original: ENGLISH

Ad Hoc Working Group on Investment
and Financial Flows; Non-debt-creating
Finance for Development; New Mechanisms for
Increasing Investment and Financial Flows
First session
Geneva, 9 November 1992
Item 3 of the provisional agenda

ESTABLISHMENT OF THE WORK PROGRAMME OF THE WORKING GROUP

Issues for consideration in the establishment of the work programme

Note by the UNCTAD secretariat

CONTENTS

		Paragraphs
	Introduction	1 - 5
I.	Policies and measures to attract foreign direct investment	6 - 13
II.	The role of foreign portfolio investment and new mechanisms	14 - 17
III.	Organization of work	18 - 21

GE.92-52040/0746K (E)

INTRODUCTION

1. On 7 May 1992, the Trade and Development Board adopted the terms of reference of the Ad Hoc Working Group on Investment and Financial Flows; Non-debt-creating Finance for Development; New Mechanisms for Increasing Investment and Financial Flows (decision 398 (XXXVIII)). Under those terms of reference, the Working Group "should provide a forum for the exchange of experiences among member States so as to enable them to draw appropriate lessons for the formulation and implementation of policies at the national and international levels and for international economic cooperation" (para. 4 of the terms of reference).

2. The field to be covered by the Working Group is extremely vast and some difficult choices will have to be made in view of time and resource constraints. In order to facilitate the task of the Working Group in formulating its work programme and setting priorities, the secretariat has prepared this note, which attempts to identify the key issues involved in that task.

3. The terms of reference of the Working Group suggest two possible components in the work programme:

(a) Policies and measures to attract foreign direct investment (FDI); and

(b) The role of other mechanisms, such as foreign portfolio investment and new instruments, in increasing investment and financial flows.

4. The first component has been the subject of intense debate in international and regional forums, such as the United Nations (notably the Commission on Transnational Corporations and UNCTAD), GATT, the World Bank Group, the Development Committee, OECD and the Group of 24. Discussions and negotiations have primarily focused on the regulatory aspects of FDI. The second component has, however, received much less attention by the international community.

5. The main issues that may be considered in examining each of these components are outlined below. The note concludes with some remarks on the organization of work.

I. POLICIES AND MEASURES TO ATTRACT FOREIGN DIRECT INVESTMENT

A. The setting

6. Since the onset of the debt crisis, developing countries and countries in transition to market economies have made considerable efforts to improve their policy and regulatory environment in order to attract FDI and the return of flight capital. The result has been a marked improvement in the investment climate and some recovery in the volume of FDI flows. However, these flows are still highly concentrated in a few destinations in Asia and Latin America, while most severely indebted countries have not yet benefited from the rebound in foreign investment. Competition among countries for FDI is increasingly fierce, especially with the progressive integration of Central and Eastern European countries into the world economy.

7. At the same time, greater emphasis is being placed on FDI as an international policy issue. In the Uruguay Round, Governments are negotiating an agreement which would provide a framework for FDI in the services sector, and other agreements on trade-related investment measures (TRIMs) and trade-related aspects of intellectual property rights (TRIPs). Since 1991, the Development Committee has discussed issues related to FDI and has asked the World Bank to prepare guidelines on the legal treatment of FDI. These guidelines will be submitted to the meeting of the Development Committee scheduled for 21 September 1992. Furthermore, the OECD instruments dealing with transnational corporations have been recently enhanced, particularly with regard to national treatment and environment, while the number of bilateral treaties for the promotion and protection of FDI has risen dramatically.

8. These developments raise a number of critical questions:

(a) What are the prospects for FDI flows making an important contribution to sustained growth in host countries?

(b) What are the causes of increased marginalization of a large number of developing countries, due to their difficulties in attracting FDI? What are the prospects and policy requirements for reversing this trend?

(c) How important today are traditional factors (such as natural resource endowment, low labour costs, and economies of scale deriving from servicing a large, protected domestic market) in determining FDI flows? What is the impact of new factors, such as privatization programmes and the development of new technologies?

(d) What lessons can be learned from the experience of countries that have been successful in enhancing the quantity and quality of FDI flows? Is adequate macroeconomic stability in host countries a necessary or sufficient condition to attract the kinds and volume of foreign investment needed to contribute to sustained growth? What are the interactions between host-country policies and global factors, such as the strategies of transnational corporations and the formation of regional trade groupings?

(e) To what extent do externalities and market imperfections justify more active government policies - in both host and home countries - influencing directly FDI flows?

(f) What changes are necessary in the incentives and regulatory systems in host and home countries in order to increase FDI flows and enhance their developmental contribution?

(g) Is competition among recipient countries in attracting FDI reducing net benefits to such countries?

(h) Is there a need for a more comprehensive and coherent international policy approach towards FDI, covering both the regulatory and financial aspects?

9. In order to answer these and related fundamental questions, the work programme could be structured along the lines described below.

B. Review and analysis of global trends and issues

10. This general review and analysis would examine trends, characteristics, geographical distribution, and sectoral composition of FDI. What are, in a global context, the key factors determining the volume, direction and use of these flows? What are the implications for national and international policies?

11. Global developments influencing the design of policies and the regulatory environment for promoting FDI would also be analysed. These global developments include: (a) the process of FDI-led market integration; (b) the growing trend of regionalization in the world economy; (c) the impact of new technologies and industrial organization on the globalization of production; 1/ (d) increasingly strong linkages between FDI and trade and payments regimes in host and home countries; and (e) complementarity of FDI with other financial flows.

C. Examination of country experiences

12. The examination of country experiences in attracting FDI may include the following elements:

(a) Host-country policies encompassing both economy-wide policies and specific measures directly affecting FDI. Among the former are structural adjustment policies, including human resource development, trade and price liberalization, privatization programmes, and the establishment and strengthening of domestic financial and equity markets. Specific measures include: the regulatory framework for FDI (admission, treatment, and expropriation of FDI and mechanisms for the settlement of disputes) and direct incentives, such as tax holidays, investment credits, financial incentives, and provision of adequate infrastructure and services.

(b) Home-country policies ranging from macroeconomic policies, such as trade, exchange and interest rate policies pursued by developed countries, to specific incentives and promotional measures, including bilateral investment insurance schemes, information services, and financial incentives through mixed credits, hybrid financing and public development finance corporations providing equity capital and loans for FDI and technical assistance for project preparation. Another relevant issue is the role and possible improvement of ODA in promoting and supporting domestic investment efforts through the financing of infrastructure and human resource development or through the blending of non-concessional flows. How effective are all these measures and the resources, including ODA, made available for their implementation?

(c) Multilateral measures consisting of international investment protection arrangements, such as the Multilateral Investment Guarantee Agency (MIGA) and the International Centre for Settlement of Investment Disputes (ICSID), promotional programmes by multilateral organizations, and financial assistance provided by international financial institutions, such as the World Bank Group and the regional development banks. What is the impact of multilateral activities on FDI flows? How complementary are the various components of these activities?

(d) Other approaches to promote investment-related financial flows, such as:

(i) debt swap programmes, including debt-equity swaps involving the conversion of both private and official bilateral debt. Among the issues to be explored are the experiences of debtor countries in implementing these programmes; their potential use and limitations.

(ii) export processing zones. What are the conditions for the successful establishment of export processing zones? What is their relationship with the domestic productive sector?

(iii) return of flight capital. The Working Group could review domestic macroeconomic policies to promote a favourable climate for investment (such as those described in point (a) above) and specific measures (such as debt-equity swaps, foreign currency deposits, tax incentives, and country funds), as well as policies and measures in developed countries.

13. In accordance with paragraph 5 of its terms of reference, "the Working Group should take due account of the diversity of country situations and experiences". In doing so, the Working Group may wish to focus on those countries that have been successful in attracting increasing flows of foreign investment as well as other countries which, despite their efforts, have not been able to expand significantly these flows. In the latter group, special attention may be given to severely indebted countries that have not regained access to international capital markets, countries in transition to market economies with an infant private sector, and the resource-poor least developed countries. 2/

II. THE ROLE OF FOREIGN PORTFOLIO INVESTMENT AND NEW MECHANISMS

A. The setting

14. The debt crisis has stimulated the search for financial instruments other than traditional FDI which provide more balanced risk sharing between lenders and borrowers, enhance the diversification of sources of finance and reduce the mismatch between foreign-exchange earnings and debt-service payments. Relevant flows include foreign portfolio investment and new mechanisms involving equity and non-equity-based finance and other market-based instruments.

15. These instruments are characterized by different degrees of ownership and management involvement from foreign investors. What are the types of instruments which would be suitable to different countries under different circumstances?

B. Foreign portfolio investment

16. The Working Group may wish to review the experiences of developing countries and countries in transition to market economies, in attracting portfolio investment through international issues of equities, country and

regional funds and foreign investment in local equity markets; measures to strengthen the policy and regulatory framework in host countries; possible approaches to international standards of supervision in equity markets; and the role of international financial institutions in promoting portfolio investment. What is the economic and financial impact of these flows on the host countries' economies, in the context of domestic capital market development and financial liberalization?

C. New mechanisms

17. A number of new financial mechanisms could be considered:

(a) Commodity-linked finance. The Working Group could analyse the supply of, demand for, and pricing of commodity-linked financial instruments, such as commodity bonds and loans, whose returns vary with the price of underlying commodity. What is the potential role of these instruments in general purpose borrowing, conversion of private and official bilateral debt, and project financing? 3/

(b) Asset-based techniques, such as build-operate-transfer (BOT) schemes. What are the conditions for the successful use of these instruments, whose returns are related to the performance of the project? Are these mechanisms likely to play a major role in attracting private investment into infrastructure?

(c) Market-based instruments for financing environmental protection, such as the tradeable carbon emission entitlements. These entitlements would control the worldwide growth of carbon emission and at the same time constitute a mechanism for transferring resources to developing countries to enable them to finance emission-efficient investment. 4/

III. ORGANIZATION OF WORK

18. It would seem necessary that, in line with the terms of reference, the method of work of the Working Group be based on active participation of national experts from both host and home countries, representatives of international institutions, private enterprises, trade unions, the academic community and non-governmental organizations. This broad-based participation of experts will be instrumental in the successful outcome of the work of the Working Group.

19. In establishing its work programme, the Working Group would need to take decisions at its first session involving:

- drawing up of priorities;
- timing of future sessions;
- sequencing of the supporting work of the secretariat;
- requests for inputs from national experts, non-governmental actors, and representatives of international institutions;

- outlines of country studies;

- launching work leading to the identification of areas in which technical cooperation should be strengthened (see para. 6 of the terms of reference); and

- possible setting up of experts groups.

20. With regard to the latter, it would be recalled that, while the duration of the Working Group is limited to two years, the issues to be examined are numerous and some of them highly technical and relatively underexplored by both policy makers and scholars. Among such issues are those related to foreign portfolio investment and new financial mechanisms which would lend themselves to detailed examination by an expert group, whose establishment could be recommended for the consideration of the Board.

21. In order to expedite its work, the Working Group may wish to devote this session not only to organizational matters but also to substantive matters. For example, a preliminary discussion on global trends and issues in FDI could take place. Such a discussion would help the Working Group in setting its priorities.

Notes

1/ In addressing this topic, the Working Group would benefit from the activities of the Working Group on Interrelationship between Investment and Technology Transfer, which will "consider the impact of technological change, including new and emerging technologies, on investment decisions and the role of foreign investment in technology transfer and technology development, including organizational technology" (para. 4 of the terms of reference).

2/ In accordance with the Board Understanding related to the terms of reference of Standing Committees and Ad Hoc Working Groups, "The Standing Committees and the Ad Hoc Working Groups, in their work, will take into account, as appropriate, the results of the review and follow-up by the Trade and Development Board of progress in the implementation of the Programme of Action for the Least Developed Countries for the 1990s". (cf. Board decision 398 (XXXVIII), annex C, "Understanding .....").

3/ This analysis should be coordinated with the work of the Standing Committee on Commodities, which, in accordance with paragraph 3 (h) of its terms of reference, will be "exploring greater use and efficiency of various mechanisms for risk management, ... including ... commodity ... bonds and loans, obstacles to their potential use and modalities for overcoming them".

4/ See the UNCTAD secretariat report: Combating global warming - Study on a global system of tradeable carbon emission entitlements (UNCTAD/RDP/DFP/1).